July 25, 2003

Mary L Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2d Fl.
Boston, MA

Re: KeySpan, D.T.E. 03-40

Dear Secretary Cottrell:

Enclosed for filing please find responses of Lee Smith and David Effron to the Department's First Set of Information Requests on behalf of the Attorney General. Thank you.

Sincerely,

Edward G. Bohlen
Assistant Attorney General

Enclosures

BOSTON GAS COMPANY
D.T.E. 03-40

RESPONSES ON BEHALF OF THE ATTORNEY GENERAL TO THE DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY'S FIRST SET OF INFORMATION REQUESTS

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-1
Date: July 25, 2003

Q: D.T.E. AG-1-1 Refer to the testimony of Lee Smith at 1. Has Ms. Smith ever testified on behalf of a gas or electric utility before a public utilities commission or a public service commission on incentive ratemaking, including performance-based ratemaking ("PBR") plans? If yes, please provide copies of Ms. Smith's testimony in each proceeding.

Response: Ms. Smith has not testified on behalf of any gas or electric utilities on incentive ratemaking before a public utilities commission or a public service commission. She has advised the Maine Office of the Consumer Advocate on PBR but has not presented testimony.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-2
Date: July 25, 2003

Q: D.T.E. AG-1-2 Refer to the testimony of Lee Smith at 1, 24-25. Please quantify the risks and benefits to customers of the PBR formula proposed by Boston Gas.

Response: While it is not possible to quantify this exactly, the following discussion is illustrative of the potential risks.

The formula proposed by the Company would increase rates annually by GDPI plus 0.2%. If the GDPI = 2.5% over the 5 year PBR, then rates would increase over the 5 years by 14%. If the initial rates overstated normal costs by just 1%, then at the end of the plan customers would be paying an additional 1.4% - probably not enough additional to ensure any revenue sharing

If "normal" gas productivity were 0.5% greater than projected, this would mean customers would be paying an additional 2.5% more annually by the last year of the PBR plan.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-3
Date: July 25, 2003

Q: D.T.E. AG-1-3 Refer to the testimony of Lee Smith at 1-3. Please discuss Ms. Smith's opinion of PBR plans in general; and specifically, her opinion regarding the PBR plans proposed by gas utilities in Massachusetts. Under what general conditions, including the term of the PBR proposal, would a PBR plan for a gas utility in Massachusetts be acceptable?

Response: In general, I think that actual PBR plans have not lived up to the theoretical promise of the PBR concept. Whether a particular PBR would be acceptable for a gas utility in Massachusetts would depend on circumstances. A more desirable PBR plan would be relatively simple, with a significant consumer dividend, should be based on an appropriate initialization of costs (i.e. cast-off rates must be correct), and should be long enough to capture increased efficiencies but not so long as to perpetuate inaccuracies in the initial rate level or inflation formula. An appropriate initialization of costs should not reflect structural changes caused by mergers or include costs that may be transitory or otherwise abnormal.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-4
Date: July 25, 2003

Q: D.T.E. AG-1-4 Refer to the testimony of Lee Smith at 5-6. Please:

1) discuss the appropriate method for selecting a representative sample of Northeast gas utilities for a productivity study of the type performed by Dr. Kaufmann. Your response should include a step by step discussion of the research design that should be used to select a representative sample and the sample size that would be considered large enough for such a study; and

2) discuss how you would address problems of missing and unreliable data in conducting such a study.

Response: 1) I do not think there is any theoretical basis for selecting a sample of Northeast gas utilities rather than a nationwide sample. Without strong evidence that productivity should change at a different rate in the region, a nationwide sample is preferable. I have not performed a research design and this would be a sizable task. The number of variables used in the PEG equation would appear to require a fairly large sample.

2) Most of the data required by the PEG study is very basic - number of customers, sales, plant values, O&M expenses - and should be available from a number of sources. If a single observation appeared aberrant and could not be replaced from an alternative source, I would prefer to interpolate between the prior and later years rather than using an aberrant number.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-5
Date: July 25, 2003

Q: D.T.E. AG-1-5 Refer to the testimony of Lee Smith at 7. What sample period should be used for the type of productivity study performed by Dr. Kaufmann? Provide reasons for your answer, including any empirical support.

Response: The sample period for a study of gas productivity should begin and end with periods in which gas utilization would be expected to be similar. This would require consideration of the impact of relative fuel prices, weather, and possibly structural factors. The consideration of weather could be eliminated by utilizing weather normalized sales.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-6
Date: July 25, 2003

Q: D.T.E. AG-1-6 Refer to the testimony of Lee Smith at 6; Boston Gas Company, D.P.U. 96-50 (Phase I) at 275 (1996). Does the productivity study conducted for the prior rate case provide any evidence that current productivity growth may be different in the Northeast than in the rest of the country?

Response: A productivity study conducted for the prior rate case will not reflect current data and trends. I have not read all of the studies produced in the previous case, but the order describes not evidence of different productivity growth, but of differences in input price growth between the region and the U.S., and differences in transportation cost levels between the region and the U.S. Neither of these speak directly to productivity growth differentials. Also, since the most recent data included in those studies appears to be nine years old, they do not tell us much about whether differentials exist currently.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-7
Date: July 25, 2003

Q: D.T.E. AG-1-7 Refer to the testimony of Lee Smith at 7-8. Please discuss what is meant by "medium term" and "longer term" in the context of your opinion that "a medium to longer term view of productivity growth is necessary."

Response: I have not performed an analysis to determine the most appropriate period for comparison, although the changes in the relative price of gas and oil during this period suggest that 1990-2000 were not comparable periods for the gas industry. The point of my testimony is that Dr. Kaufman has also not performed such an analysis.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-8
Date: July 25, 2003

Q: D.T.E. AG-1-8 Refer to the testimony of Lee Smith at 7-8. What time period(s) would be indicative of the "normal" future growth rate for the (1) total business sector and (2) the gas industry? Provide support for your answer.

Response: I have not performed an analysis to identify the normal time period for either the gas industry or the total business sector. Given the unprecedented growth in the entire economy, either 1999 or 2001 would probably be a better end point than 2000 for the entire economy. For the gas industry, the time period should be long enough so that the "weather" included in the period approximated normal weather. This might allow an averaging of the annual productivity growth within the period, rather than relying only on two end-points. Another concern, however, is the relationship between gas and oil prices.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-9
Date: July 25, 2003

Q: D.T.E. AG-1-9. Refer to the testimony of Lee Smith at 9. Please provide support for your contention that the relationship between various energy prices is not related directly to the national business cycle.

Response: While both the price of gas and the price of oil can have an effect on output in the economy, it is not at all evident that growth in the economy would cause one fuel price to increase more than another, or that growth in one fuel price relative to another would have an effect on overall economic growth. While the economy grew every year from 1991 to 2000, during this same period gas prices first rose relative to oil prices, then fell, then rose again, then fell again.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-10
Date: July 25, 2003

Q: D.T.E. AG-1-10 Refer to the testimony of Lee Smith at 9. Please discuss how PEG should have taken into account "the impact of weather on the time period over which productivity was measured, or the impact of relative energy prices" in the measurement of productivity.

Response: I have not performed an analysis to determine the most appropriate period for comparison, although the changes in the relative price of gas and oil during this period suggest that 1990-2000 were not comparable periods for the gas industry. The point of my testimony is that Dr. Kaufman has also not performed such an analysis.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-11
Date: July 25, 2003

Q: D.T.E. AG-1-11 Refer to the testimony of Lee Smith at 10. What is "EAIA"?

Response: EAIA stands for the Energy Administration Information Agency, a part of the Department of Energy.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-12
Date: July 25, 2003

Q: D.T.E. AG-1-12 Refer to the testimony of Lee Smith at 10. Please provide support for your contention that "new housing construction may not follow the business cycle."

Response: Because housing construction is sensitive to the level of interest rates, low interest rates as a result of fiscal attempts to stimulate the economic will usually, as at the present time, increase housing construction. New housing starts are one of the "leading indicators", because they tend to lead rather than be coincident with the general business cycle. See attached article.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-13
Date: July 25, 2003

Q: D.T.E. AG-1-13 Refer to the testimony of Lee Smith at 10. Please discuss the relative significance of the effect of the "factors described above" on PEG's gas productivity analysis. Is the effect very significant, significant, somewhat significant, or not significant? Provide reasons and any support for your answer.

Response: I have not performed an analysis to determine the most appropriate period for comparison, although the changes in the relative price of gas and oil during this period suggest that 1990-2000 were not comparable periods for the gas industry. The point of my testimony is that Dr. Kaufman has also not performed such an analysis.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-14
Date: July 25, 2003

Q: D.T.E. AG-1-14 Refer to the testimony of Lee Smith at 11-12. Please provide support for your assertion that "many utilities in several states have survived and in some cases prospered with no increases in their delivery service rates."

Response: In Pennsylvania, all of the electric utilities operated under distribution rate caps from 1998 to the present. In Massachusetts, all of the electric utilities have been operating under distribution rate caps since the Restructuring legislation. In Arizona, Arizona Public Service has been reducing its total rates since 2001 and its distribution rates since about 1996. APS has just filed for a rate increase, but most of the claimed deficiency results from power costs.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-15
Date: July 25, 2003

Q: D.T.E. AG-1-15 Refer to the testimony of Lee Smith at 11-12. Please provide support for your assertion that "the components of delivery service are not dramatically different between gas and electric utilities." As part of your response, discuss any similarities and differences between the delivery services provided by gas utilities and electric utilities in relation to technology used, manpower requirements, and equipment needs.

Response: Gas and electric are both capital intensive industries; operating and maintenance expenses for both consist of maintaining lines or pipe spread over the entire territory, and providing customer service. Both industries' revenues are sensitive to weather and to changes in the price of energy substitutes.

- In most areas, electric utilities must extend service to new customers, but gas utilities are not required to.
- Electric maintenance involves both under and above ground work, while most gas work involves underground work.
- The materials used by both industries have both experienced significant technological change, although the materials are different.
- Both industries utilize primarily skilled labor.
- Both industries utilize small to medium trucks and other equipment to assist in line maintenance.
- Both industries have similar meter reading, customer billing, and customer accounting requirements.
- The gas industry appears to be slightly more capital intensive than the electric industry.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-16
Date: July 25, 2003

Q: D.T.E. AG-1-16 Refer to the testimony of Lee Smith at 12. Please provide support for your recommendation that the Department should assume, absent PBR, that "the gas industry would experience productivity growth similar to productivity growth in the private business sector." As part of your response, discuss any structural similarities and differences between the gas industry and the private business sector which warrant your recommendation. How different is your recommendation from the assumptions made by Dr. Kaufmann in his productivity study?

Response: I do not think that the PEG MFP study of 1990-2000 is an adequate basis for the Company's claim that gas utility MFP in the Northeast is lower than MFP in the private business sector. The most accessible data on sectoral MFP is that published by the Bureau of Labor Statistics. Their data includes the MFP of the combined gas and electric industries up until 1998. The attached table contains MFP index data for the private business sector and for the gas and electric industry. I have also computed the annual change in these indexes for a number of periods. If 1984-1996, 1990-95,1990-96, or 1990-1997 were relied on, productivity growth in the gas and electric industry was greater than in the private business sector. Only during the period 1990-1998, after two years of stagnation in the gas and electric industries, did productivity growth in the private business sector exceed that in the utility industries. These results suggest that productivity growth is fairly volatile, but that the gas and electric industries are not much different from the private business sector. The differences between the gas and electric industries, as discussed in D.T.E. AG-1-15, are not major. The difference that is most likely to have an effect on productivity growth is the higher share of capital in gas industry costs.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-17
Date: July 25, 2003

Q: D.T.E. AG-1-17 Refer to the testimony of Lee Smith at 11. As used in your testimony, is the "private business sector" the same as the "total business sector?"

Response: Yes.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-18
Date: July 25, 2003

Q: D.T.E. AG-1-18 Refer to the testimony of Lee Smith at 13. Define the term "average system prices" as used in your testimony. Please provide any support for your recommendation that the Department assume "gas input prices change at the same rate as the average system prices."

Response: By average system prices, I meant average prices in the economy, as measured by GDP-PI. The only information on the record is the PEG finding that gas input prices' rate of increase is very slightly lower than average system prices. This is due evidently to the higher proportion of capital in gas inputs. It is not clear whether this advantage will continue, and the difference in input price increases is small. If the DTE accepts my recommendation to assume that gas productivity will increase at the same rate as the economy, I would recommend that there is not sufficient evidence to adjust for the recent past difference in input price growth.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-19
Date: July 25, 2003

Q: D.T.E. AG-1-19 Refer to the testimony of Lee Smith at 13-14. Using data for the period 1990 to 2002, please discuss any structural similarities and differences between the gas industry and the overall economy with respect to (1) the capital-output ratio, (2) the labor-output ratio, and (3) the capital-labor ratio.

Response: The gas industry has a higher of capital to other inputs and a higher capital-output ratio than the economy as a whole. I am not familiar with the labor/output ratio and the capital-labor ratio, although I believe that the former is lower and the latter is higher than average for the economy.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-20
Date: July 25, 2003

Q: D.T.E. AG-1-20 Refer to the testimony of Lee Smith at 14-19. Please:

1) describe how you would design a cost study of the type performed by Dr. Kaufmann. State clearly your research design, including descriptions of the data, variables, econometric modeling and estimation methods you would use;

2) support your choice of research method, including the data, variables, econometric modeling and estimation methods you would use; and

3) discuss any differences between your research method and the method used by Dr. Kaufmann in his cost study.

Response: Designing such a cost study would be a major undertaking. It would take more time than is available to fully critique Dr. Kaufman's basic econometric techniques and the assumptions that underlie them. However, there are some potential variables that have strong economic underpinnings that I would make more effort to test and include if relevant. These include particularly the two factors mentioned in my testimony, that of customer growth and customer density.

With regard to research method, I believe that the capital cost computed by Dr. Kaufman is problematical. Given the importance of capital cost, this issue would require more scrutiny. The problems are both in the measurement of the capital stock and in the capital services computation.

1) Dr. Kaufman's adjustment of capital stock values is simplistic to derive his "capital quantity index", as it assumes that the average life of all utility plant in 1983 was the same, and it assumes that the all gas utilities had the average proportion of plant in different accounts, and added plant over time in the same proportions. However, another concern is that older gas utility plant may be fundamentally undervalued by this method.

2) According to the reference article by Christensen & Jorgenson provided by Dr. Kaufman in response to AG-7- , income taxes must be taken into account in the service price. The PEG analysis, rather than computing income taxes as part of the rate of return, adds actual total taxes to the computed non-tax capital cost, which is service price multiplied by capital quantity index. This means that actual property taxes, payroll taxes, income taxes, and even franchise taxes are reflected as part of the capital cost. According to the data contained in the response to AG-12-10, among the Northeast utilities in 2000, taxes as a percent of capital cost varied from a low of 14.84% to a high of 42.36%, with Boston Gas the second lowest at 16.63%. Comparable data on capital cost and taxes was not provided for the U.S. sample that was used in the cost study, so we do not know how much taxes may have varied. Since the utilities do not have control over the taxes paid, it would seem to be inappropriate to include the impact of taxes in the cost study or the productivity study. If the average utility in the cost study has higher taxes than Boston Gas, due to factors not under utility control, such as state tax policy, the cost study would overproject capital costs for Boston Gas.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-21
Date: July 25, 2003

Q: D.T.E. AG-1-21 Refer to the testimony of Lee Smith at 19. Please discuss why you expect that "Boston Gas' system is dense relative to the nationwide sample?" What measure of density "might have produced better results" than the density variable used by Dr. Kaufmann in his study?

Response: This is based on general knowledge – gas systems in the Midwest and West tend to serve territories that are much more rural in nature than in the East. The data provided in response to AG-18-8 illustrates this - Boston Gas and other Northeast utilities have about 100 customers per mile of distribution main, while Illinois Power, Oklahoma Natural, Northwest Natural, and Mountain Fuel, have about 40 customers per mile of distribution main.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-22
Date: July 25, 2003

Q: D.T.E. AG-1-22 Refer to the testimony of Lee Smith at 21-22. Please discuss what is meant by the term "real evidence?" How would you demonstrate whether or not Boston Gas is an efficient performer?

Response: What constitutes quantifiable, reliable, probative "real evidence" would depend on circumstances. Evidence of a comparable level of efficiency could be based on econometric analysis or direct comparison to other utilities. Any econometric analysis must encompass all variables, including the size of the utility, and must measure costs accurately. Benchmark studies from similar utilities could also be useful evidence. In both cases, the comparison is primarily with other utilities that have been operating under cost-of-service ratemaking.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-23
Date: July 25, 2003

Q: D.T.E. AG-1-23 Refer to the testimony of Lee Smith at 23. Please provide support for your observation that "the electric distribution companies reduced their labor forces significantly from about 1996 to the present, when faced with competitive pressures and with rate caps."

Response: These lists are not comprehensive.

A) Boston Edison has been reducing its labor force since several years before divestiture. Likewise, Central Maine Power and Public Service of New Hampshire have been reducing their labor forces both before and after divestiture.

B) Presumably all utilities that have divested all of their generating assets have reduced their labor forces.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-24
Date: July 25, 2003

Q: D.T.E. AG-1-24 Refer to the testimony of Lee Smith at 24. Please:

1) provide copies of any PBR plans proposed by gas or electric utilities in other jurisdictions. Also, provide copies of any commission orders regarding such PBR plans;

2) for each PBR plan, provide a summary of both the proposed and approved: (a) price cap formulae (including the value of the parameters), (b) PBR plan term, and (c) earnings sharing mechanism;

3) show how the consumer dividend was calculated in each case; and

4) discuss the similarities and differences between each PBR plan and the PBR plan proposed by Boston Gas.

Response: 1) I do not have copies of the proposed PBR plans. Attached are orders (bulk for Department and Company only) —

2) a) SoCal - the plan subtracts from the CPI a productivity factor of 1.2%, 1.4%, and 1.6% in 1999, 2000, and 2001.

b) San Diego Gas and Electric - inflation factor is based on DRI inflation factor forecasts for utility inputs, weighted by California specific weights. Rate increase reduced by x factor of 1.085%, 1.23%, and 1.38% for 2000, 2001, and 2002.
Please see attached report by the California PUC for additional details.

c) The earning sharing mechanisms in each are fairly complicated and cannot be easily summarized.

3) In the Central Maine Power case the consumer dividend was the result of negotiation between the parties. I am not sure of the basis for the consumer dividend in the California gas utilities.

4) The CMP and the SoCal plans reduce the overall inflation rate by an x factor, whereas the San Diego plan reduces a gas specific inflation factor by an x factor. The Bangor Gas PBR plan was unique in that it was designed for a start-up utility, which still has very few customers. It provided the utility with a great

deal of flexibility to allow it to build load.

Q: D.T.E. AG-1-25 Refer to the testimony of Lee Smith at 29. Please:

1) provide the bases for your recommendation that, if the Department finds PBR is warranted, we use the same formula that was "utilized in the previous PBR plan;"

2) provide any evidence supporting a consumer dividend of from 0.3 to 0.7 percent;

3) provide theoretical and empirical support for the conclusion that "[t]aken together, rates should change at the rate of the Gross Domestic Price Inflator less 0.5%;" and

4) discuss the reasons why Boston Gas' proposed earnings sharing mechanism should be adopted.

Response:

1) There is not adequate support for the proposition that normal gas industry prices change at a rate different from that of the GDP-PI to justify making any adjustments to the basic inflation index utilized.

2) While I believe the PEG cost study is imperfect, it provides evidence that Boston Gas actually decreased their costs by 0.3% under PBR. The experience of the California utilities is that gas utilities can operate successfully with a consumer dividend of up to 0.7% in some years. In Maine, the major electric utilities have operated successfully with a higher consumer dividend since 1997.

3) This should have read "will change", as it was not meant to be normative, but merely to reflect the effect of the recommended formula. Theoretically, I have supported a consumer dividend of this level because I do not think PBR benefits ratepayers if it does not improve productivity growth, and if significant benefits are provide to ratepayers, to compensate for the risks entailed in PBR. Empirically, the experience in California, Maine, and Massachusetts demonstrates that a consumer dividend has worked.

4) In her testimony, Ms. Smith intended to express the need generally for an earnings sharing mechanism, not to endorse the specific earnings sharing mechanism proposed by the Company. The Department should adopt an earnings sharing mechanism because it reduces the risk of a PBR plan to both ratepayers and to the Company.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-26
Date: July 25, 2003

Q: D.T.E. AG-1-26 Refer to the testimony of Lee Smith at 9, lines 3-5. Please provide support for your statement that "most projections are that economic growth will be slower in the next five years.

Response: The information on which this statement is based is extensive. Attached is a projection by the Congressional Office of the Budget, which forecasts growth of 3% per year. Recently Federal Reserve Chairman Alan Greenspan has expressed concern that if gas prices remain high this will depress economic growth, presumably below that forecasted.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-27
Date: July 25, 2003

Q: D.T.E. AG-1-27 Refer to the testimony of Lee Smith at 10, lines 1-5. Please provide support for your assertion that the magnitude of the relative change in gas prices can be expected to lead to a reduction in gas use or in its rate of growth.

Response: Since gas and oil are substitutes for many uses, if oil prices fall relative to gas prices, many customers will switch from using gas to using oil. Dr. Kaufman testified orally (transcript Vol. 11 p. 1355) that Boston Gas' future productivity could go down if oil prices decreased relative to gas, because gas sales would decrease.

The Attorney General
Respondent: Smith
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-28
Date: July 25, 2003

Q: D.T.E. AG-1-28 Refer to the testimony of Lee Smith at 18, lines 1-4. Please provide support for your assertion that "each utility has a different proportion of total plant in these different plant accounts."

Response: The attached table contains end of year plant balances from the Annual Reports of 4 different utilities. The percentages of selected major accounts to total plant is computed.

D.T.E. AG-1-29 Refer to the testimony of David J. Effron at 9. Please reconcile the difference between the total incremental cost adjustment of $7,256,000 and the A&G expense of $6,880,000.

Response: See the response to AG-11-8. The difference represents expenses charged to accounts other than the A&G Accounts 920-930.

The Attorney General
Respondent: Effron
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-30
Date: July 24, 2003

D.T.E. AG-1-30 Refer the testimony of David J. Effron at 14. Could the Company have made tax deductible contributions to its qualified pension plan in the years 1997 through 2000? If the response is negative, please explain why the contributions in 2001 and 2002 include a catch up for the zero funding in the earlier years.

Response: Mr. Effron did not investigate the question of whether the Company could have made tax deductible contributions to its qualified pension plan in the years 1997 through 2000. The contributions in 2001 and 2002 include a catch up for the zero funding in the earlier years because if contributions had been made in the earlier years, the difference between the benefit obligation and the balance in the pension funds would have been less in 2002, requiring less of a contribution in that year, other things equal.

The Attorney General
Respondent: Effron
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-31
Date: July 24, 2003

D.T.E. AG-1-31 Refer the testimony of David J. Effron at 16. Please explain why using a five year averaging period which includes three years of zero contributions provides a more representative level of future contributions to the Company's qualified pension plan.

Response: See the response to D.T.E. AG-1-30. To the extent that the 2002 includes a catch-up for zero funding in prior years, the future funding will probably not continue to include such catch up amounts. In addition, as Mr. Effron states in his testimony, in determining the pension expense to include in the cost of service, the periodic pension expense pursuant to SFAS 87, as well as the expected level of future contributions, is also a relevant consideration.

The Attorney General
Respondent: Effron
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-32
Date: July 24, 2003

D.T.E. AG-1-32 Refer to the testimony of David J. Effron at 16. Please explain why you recalculated the Company's estimate of its 2003 SFAS 87 pension expense. Why is this figure relevant?

Response: Mr. Effron recalculated the Company's estimate of its 2003 SFAS 87 pension expense because it appeared to be an overestimate based on information available. The SFAS 87 pension expense figure is relevant, even with the Department's cash contributions pension precedent, because it is used by the Company in its per books accounting.

The Attorney General
Respondent: Effron
D.T.E. 03-40
Information Request: IR-D.T.E. AG-1-33
Date: July 24, 2003

D.T.E. AG-1-33 Refer to the testimony of David J. Effron at 17. Under the proposed reconciliation mechanism, will pension costs for cost of service purposes be measured by FAS 87 pension expense and not contributions to the Company's pension plan, as was previously the case?

Response: It is Mr. Effron's understanding that reconciliation mechanism as proposed by the Company would compare the pension expense included in the cost of service in this case to the SFAS 87 pension expense and recover (or refund) the difference from (to) customers. Therefore, although the pension expense included in the cost of service in this case would reflect estimated contributions, the actual amount recovered from customers in the total revenue requirement, including the reconciliation mechanism, would reflect the SFAS 87 pension expense.

D.T.E. AG-1-34 Refer to the testimony of David J. Effron at 18. Would the proposed reconciliation mechanism transfer the claimed volatility in pension costs from the Company to its ratepayers?

Response: Yes. As Mr. Effron understands the proposed reconciliation mechanism, it would transfer the claimed volatility in pension costs from the Company to its ratepayers.